The Government and the Railroads

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THE GOVERNMENT AND THE RAILROADS

I

WHAT is to be done with the railroads? They were taken by the President for the national defense. But the war emergency has passed, and from over the country comes an insistent demand that the Government speedily return the roads to their owners, and at the same time reform our antiquated system of railroad regulation.

But a little while ago Government ownership of all the means of transport and communication was looming on the horizon as the major issue of national politics. The Republican party was evidently eager to go before the country in opposition to state socialization of industry, but shrewd Democratic leaders saw which way the wind was blowing, and almost overnight Government ownership was found to be without any real support as an issue between the great parties. The Democratic press is now pointing out that the party never was a Government-ownership party, and that it was the wily Republicans who were trying to force the issue.

Meanwhile the Government has on its hands 260,000 miles of railroads, receiving from the public more than five billion dollars a year, paying two and three-quarters billions in wages to two million workers, buying more than one and a half billions worth of steel products, coal and other supplies, and obliged to find more than five hundred millions of new capital each year for the necessary expansion of facilities. During the few months that the Government has directed railroad operation it has increased the cost to the public of freight and passenger transport more than a billion dollars a year: the service that was done for four billions now costs more

than five. It has raised the payroll by nine hundred million dollars. It so miscalculated its probable income and outgo that instead of making an expected surplus above the rental to be paid the owners, it was obliged at the end of the first year of Government operation to go to the Treasury for two hundred millions to make up a deficit; and it is now losing close to a million a day.

For the moment the owners — those hundreds of thousands of investors who never attend a shareholders' meeting, and those millions of citizens whose indirect ownership in the companies is held for them in trust — these owners are fairly comfortable. The Government is paying them a rental of $900,000,000 a year, or about five per cent on their $18,000,000,000 of property. They are in receipt of their interest and dividends. Many of them, no doubt, taking a purely selfish view of the situation, would be glad to have the Government permanently shoulder the burdens and hazards of the business, continuing to pay them the rental for the use of their property. But the owners are not in so secure a position as might seem to one who does not look ahead. Within a few months the Government will return these properties to the owners. The rental will cease; there will be no convenient Treasury from which to make up an operating deficit. If the new rates fixed by the Railroad Administration are insufficient to meet the higher operating costs the resumption of private management might easily be followed by a financial collapse that would shake the country.

II

The experience of the Government with railroad operation has not been a happy one. For that matter, the war played havoc with railroad finance in all the Allied countries. The English roads are potentially bankrupt, and nationalization seems to be the only way out of the muddle. In France the companies are hopelessly in debt to the State as a result of the very large advances that had to be

made to them on account of the guarantee of income. Our problem is simple compared with theirs. In this country, at least, we have pretty well determined what general course we are going to pursue with relation to Government ownership and operation, and this is more than they have been able to do abroad.

The President will relinquish control of the roads sometime before the expiration of the period named in the law — twenty-one months after the declaration of peace. Of this there can now be no doubt. The former Director General, apologizing for the unsatisfactory results of the first year of Government operation appealed to the Democratic Congress for an extension of Government control to five years after the war, in order that an adequate test might be made of nationalized operation. His successor argued eloquently to the same purpose. But Congress turned a deaf ear to the proposal, and from over the country rose an angry protest against further Government meddling.

It would need a deep searching into political psychology to determine just why public opinion has so rapidly and unmistakably crystallized in opposition to Government ownership. It may be that our sudden emergence from the war for democracy has left us with such a repugnance from Prussianism, autocracy and centralization of political power that we have unconsciously reverted to our older ideals of individual freedom. The old *laissez faire* doctrine that the State should undertake nothing that can be better done by private initiative, so well expounded by Herbert Spencer and his followers, ran all through the President's address to the Congress before his first departure to the Peace Conference. He not only suggested the early relinquishment of Government control of the railroads, but threw aside as visionary the idea that the Government should keep its hand on industry during the period of transition from war to peace.

It is also plain that public opinion in this country has been strongly influenced by the political chaos in Russia and the Central Empires and the rumblings of trouble nearer home. The reaction against the excesses of Bolshevism is plain. There is an evident purpose throughout the country to get back as soon as possible to American fundamentals, and to work out our future salvation on a foundation tested during the long years we were rising to our present position as a world power.

A factor more evident is that the country has had a taste of political domination of the railroads and finds that the reality compares most unfavorably with the promise of political prophets. It was with high hopes that the Administration undertook the operation of the railroads as a unified national system. Great operating economies were to be effected, the labor problem was to be settled, and complete coördination of all transportation facilities with the elimination of wasteful competition was confidently anticipated. Time and time again railroad critics had painted a roseate picture of the varied economies that would provide for rising labor and material costs and make rate increases unnecessary. The Government, with a popular and able Director General, and an expert administrative staff picked from the best managed roads, started out to show how the transportation system could be conducted with a maximum of efficiency. Hundreds of millions a year were to be saved. The Railroad Administration was obviously in a very advantageous position to achieve its goal. It was bound by no restrictive laws, as the private companies had been. The war power of the President was such that every Federal and State legal obstacle could be set aside, and these handicaps that for years had obstructed the development of the railroads under private management were at once removed.

But, to the amazement of those who had been dreaming of other things, it was soon found that Government

operation was resulting, not only in poorer service, but in much higher charges for this deteriorated service. Within a short time after the Railroad Administration took charge, the Interstate Commerce Commission granted an advance in rates to the Eastern roads that a short while before had been refused the private companies; and a little later, by Presidential order, without any public hearing, there was a wholesale advance in both freight and passenger rates. The Government marked up overnight the price of transportation to the public from $4,000,000,000 a year to $5,000,000,000; and at the same time began effecting economies which meant a deterioration of the service.

When the former Director General retired to private life he presented to Congress some detail of these savings. They amounted, so far as he could then ascertain, to $120,000,000 a year. But it appeared that $80,000,000 came from taking off passenger trains and crowding the remaining trains — a war sacrifice that the people at home gladly made to provide more transportation for our men and munitions bound overseas. The people would have done entirely without civilian passenger service — they would have crawled on their hands and knees — if this had been necessary to make sure that our armies would be sent to France in time to turn the tide of battle. But this war sacrifice of passenger facilities surely cannot by any honest use of the word be described as an economy. The bulk of the other savings were similarly made — the cutting out of informative advertising, the closing of travel and traffic bureaus, the reducing of comforts — all war sacrifices that the public cheerfully accepted as necessary to the winning of the war. In fact, nearly all the "savings" of the Railroad Administration were made in the same way that the people saved bread and meat and sugar. The people did without in order that others might have. With the return of peace most of these economies vanish.

III

Against these disappearing economies must be set the extraordinary increases in operating costs, the bulk of which are permanent and for a long time to come will be an almost insuperable obstacle to any reduction in the charges for transport. The actual increase in expenses in the year of Government operation, as compared with the last year of private operation, was $1,150,000,000, of which $525,000,000 was for coal and materials, and $625,000,000 for labor. The high prices for supplies were the inevitable result of the war, and the Government took commendable measures to keep them within bounds; the same high prices would have been paid by the railroads had they continued under private management. These war time prices are falling, but there is little hope of getting back to the prewar level, on account of the greatly increased labor cost.

The wage advance is much more than appears on the surface of the accounts, because very considerable increases were made late in the year, and the payroll is now at least $900,000,000, or 50 per cent higher than in the last year of private operation. It is this unprecedented addition to the cost of producing transportation that has upset the calculations of the Administration and destroyed any hope of economical national operation.

When the Government took control it was recognized that wage advances ought to be made to many of the employes; their compensation could not meet the higher cost of living, in spite of the fact that the railroad companies, since the outbreak of the war in Europe, had advanced wages by $350,000,000 a year. It was the belief in Washington at the time that a duplication of this advance would be more than the workers would need, or that a generous wage board would be likely to award. The commission, headed by a member of the Cabinet, after making an exhaustive study of the subject, recommended advances aggregating $288,000,000; and, in making its report, it

asked the public not to look on this amount as "staggering," as it was an average increase of only fifteen per cent.

But that was only the beginning. It was soon found that other classes of workers were dissatisfied. "If those fellows deserve what they are being paid, then we ought to get more," was heard all along the lines. The Administration found that instead of settling the labor problem, he had just begun to deal with it. A series of supplements to the original award began to issue from the office of the Director General, each of them involving many millions, and at the end of the year the advances amounted to more than three times the original award, with still more to follow. It needed a man of great courage to resist the appeals of the labor spokesmen, especially when these appeals had behind them the weapon of the strike; and the Administration was ready, in the national defense, to make almost any sacrifice rather than see the transport of troops and munitions of war stopped for a single day.

Lloyd George had the same problem to face in England, only in much more aggravated form. He dealt with it with as much courage as he could, but he was always looking across the Channel at that line of English soldiers with their backs to the sea.

When the English Government took control of the railroads for war purposes, guaranteeing the prewar income to the owners, the annual revenues were $680,000,000, coal and materials cost $180,000,000, the payroll was $250,000,000, and there was left for capital $250,000,000, or somewhat less than four per cent on the investment. The wages were low, and they seemed even lower in comparison with the earnings of munition workers. The Government attempted to deal with the problem by giving "war bonuses" based on the rise in the cost of living. The workers gladly took the money but they objected

to the way it was tagged. They wanted wages, not bonuses; and the Government soon dropped the word. These advances were repeated at intervals during the war, until they finally amounted to $280,000,000, or more than the original payroll. And at the end of the war the Government was obliged to grant the eight-hour day, adding $120,000,000 more, making a total advance of $400,000,000, or 140 per cent. The English railroad payroll is consequently up to $650,000,000 a year, close to the total revenues at the beginning of the war. An increase in passenger fares has added considerably to the revenues, but hardly enough to pay for coal and materials, after meeting the payroll. The workers, in fact, have taken all the receipts of the companies, and the Government is paying the rental out of the public Treasury.

The English roads are potentially bankrupt. If returned to their owners they could not earn dividends or interest; some of them would probably not even earn operating expenses. How private management is to be resumed is a difficult problem, so difficult, indeed, that it is believed the only way out of the muddle is nationalization. A freight rate increase of fifty or sixty per cent would be necessary to enable the companies to survive, and no Government would have the courage to grant such an increase. Nationalization would make possible covering the deficit by general taxation, just as the French Government absorbs the losses of the State Railways. Our Administration did not make the mistake of England in meeting rising labor costs out of the Treasury; the Director General here boldly raised rates by a billion dollars to keep the roads self-sustaining — his only miscalculation was the amount of additional rates needed: he made a mistake of several hundred million dollars.

Fortunately the American roads have not become so hopelessly involved with the public finances as have the English and French roads, and we can soon restore our roads to their former managements and retain for the

country the obvious advantages and efficiency of private ownership and operation. The country today is almost unanimously of the opinion that the roads ought to be restored at the earliest possible date, and that the Government should speedily divorce itself from the business fe railroading. As a matter of honest dealing, and to insour the future solvency of the companies, the Government has three duties to perform before it relinquishes control of the properties: (1) it must provide for the funding of the railroads' debts to the Government, growing out of additions to the lines during the period of Federal control; (2) it must make good any depreciation in the properties resulting from its failure to perform necessary maintenance work; (3) and, what is of the greatest importance, it must make sure that the rates it has established and that will continue in force are adequate to meet the higher operating costs it has placed on the roads.

IV

But the larger question growing out of the return of the roads to private operation is the one brought before the Congress by the President when he said in December last: "It would be a disservice alike to the country and to the owners of the railroads to return to the old conditions unmodified. Those are conditions of restraint without development. There is nothing affirmative or helpful about them. Some new element of policy, therefoie, is necessary."

What are these restraints to development? What are the reforms that ought, in the public interest, to be made? What, in fact, is the railroad problem before the new Congress? And what ought Congress to do?

The fundamental difficulties that the railroads have faced in recent years are:

(a) The Federal and State Governments, in regulating rates, have failed to allow prompt advances to meet the rising cost of labor and materials.

(b) The States, through their legislatures and commissions, have not only placed obstacles in the way of a unified policy of national regulation, but have broken down the rate structure by substituting lower State rates for higher Federal rates.

(c) Federal laws forbid the combinations and mergers of railroad lines and facilities demanded in the public interest.

These obstacles were immediately thrown aside by the Railroad Administration when it assumed control. The Director General raised the rates as much as he thought was necessary to meet his higher costs — the advance in the East was three times as large as the roads had ever had the courage to ask for, and eight or nine times as large as they had ever received. He cast aside all Federal and State laws that in any way interfered with the free operation of the roads as a national system. The business was conducted, in fact, unrestrained by the handicaps under which the private managements had labored.

During Government control the public has had an object lesson in the benefits to be derived from the removal of restrictions to the merger of competitive lines and the common use of facilities. The country will not willingly abandon these reforms, and there is abundant evidence that public opinion strongly favors such a modification of the anti-tiust laws that apply to railroads, as will permit combinations in the public interest. The Interstate Commerce Commission has recommended such a revision of the laws, and Congress is ready to act.

The conflict between State and Federal regulation presents a more serious problem. While there is a strong public opinion in favor of giving to the Federal Government absolute control of railroad regulation, especially as to rates, this opinion is not, in the judgment of political leaders in Washington, sufficiently crystallized to warrant the drastic legislation that the situation really re-

quires. Here again the experience of the Railroad Administration has been a good object lesson, although the rebellion of the State commissions against orders of the Administration shows that a truly national system of regulation will not be achieved without a lively struggle. Exclusive Federal regulation of the issuance of securities is likely to be the first reform accomplished; then will follow the substitution of Federal for State charters — and that will mean the beginning of the end of the interference of the States with national regulation.

In the decade before the Government took control, when interest rates the world over were rising, inadequate rates resulted in a falling income; in consequence investors turned to ventures where there was a greater certainty of income or a larger opportunity for profit. The railroads, therefore, found it increasingly difficult to obtain from their shareholders necessary new capital for expansion, and they were obliged to borrow the greater part of their new money; railroad debts, in bonds and notes, accordingly rose well above the danger point, and, as is the case in any business, the more the debts expanded, the more difficult it was to get any new capital from the shareholders. The interest of the creditors has been growing larger, while that of the owners, or partners, has been growing smaller.

The adequacy of rates is at the crux of the problem. As was so well stated by the Interstate Commerce Commission in its decision in the 1910 Eastern Rate Case: "If we are to rely in the future, as we have in the past, upon private enterprise and private capital for our railway transportation, the return must be such as will induce the investment. It is, therefore, not only a matter of justice, but in the truest public interest, that an adequate return should be allowed upon railway capital." The Commission in 1914 recognized that earnings were gradually declining, and that they were then below what

was demanded in the public interest, but it was only after strong pressure had been brought to bear by the White House that the Commission grudgingly allowed a small advance in rates. The advance granted in 1917 was again plainly inadequate, as was shown by the very much larger advances made a few months later by the Government for its own benefit. The Commission has lacked the courage to deal boldly with rates, and has kept them just above the point of confiscation, rather than at a level that would encourage the free investment of capital.

V

How shall adequate rates be assured? Of the many plans presented since the end of the war, all are built up on one of these three foundations:

(1) Private ownership and operation, substantially as it was before the war, with a positive Government policy encouraging prompt adjustments of rates to operating costs, assuring a return on capital liberal enough to invite new investment in competition with other industries.

(2) Private ownership and operation, but with a Government financial partnership, whereby the Government will guarantee a minimum income, and share in excess earnings, either (a) by a guarantee of earnings on all the roads of a given territory taken as a whole, or on the individual properties, or (b) by the guarantee of interest and dividends on securities.

(3) Government ownership, or Government participation in the ownership, with private operation.

Public discussion is now largely concerned with the question of a guarantee of earnings. This proposal is not be confused with the guaranteed rental the Government is now paying for the use of the roads. There is a vast difference between a guaranteed rental for the use of the railroads, paid to the owners by the Government out of the net revenues it receives while in possession of

their properties, and a guarantee to these same owners, while they are operating the properties for their own account, that their profits shall not fall below a certain minimum.

It is true that the system of regulation under which the roads were operating before the war was in theory a Government guarantee of earnings. Having assumed control of the income of the roads, through the fixing of rates, the Interstate Commerce Commission, by act of Congress, was bound to fix reasonable rates and not to establish a level that would in effect confiscate the property. The practical working of this guarantee-in-theory has been that, in a period of rising commodity prices, the Commission has been slow to respond to the appeals of the roads for relief, and transportation has starved while the Commission has deliberated.

The advocates of a positive guarantee of a minimum income assert, with some basis of fact, that the old system of an implied guarantee of non-confiscation has broken down, and that there must be something more substantial to attract the hundreds of millions of new capital the railroads must have each year to keep abreast of the commerce of the country. One proposal, coming from insurance companies and other institutions having a large investment in railroads, is that the Government shall guarantee that the income of the roads in each of the three rate territories (East, West and South) shall aggregate six per cent on their property investment, and that individual roads earning more than six per cent shall share their excess profits with the Government. Another proposal, put forward by one of the ablest railroad bankers, is that the Government shall guarantee a minimum income to each company, on its true valuation, and that profits in excess shall be shared with the Government. Most of the guarantee plans include some kind of profit sharing with labor.

The proposal of a Government guarantee of earnings is by no means novel. Such a system has been in operation in France for many years, and it is interesting to observe the results. The most important of the successive contracts between the Government and the railroads was that of 1883, which provided:

(a) Six regional monopolies, radiating from Paris.

(b) State participation in the first cost of a number of weak lines to be absorbed by the great companies, and in the construction of certain new lines.

(c) State guaranty of interest and amortization of bonded debt, and guarantee of minimum dividends and amortization of share capital; funds advanced by the State under the guarantee to be loans at 4 per cent, to be repaid from future earnings or to be balanced against the rolling stock at the end of the concession, or in case of purchase by the State.

(d) Earnings in excess of the guarantee (after payment of any debt to the State) to go to the shareholders up to a certain level; after that two-thirds of the excess to go to the State.

(e) At the expiration of the hundred-year concessions (1950–60) the properties to revert to the State, the companies to be paid for their rolling stock and supplies.

(f) The State (after 1898) to have the option of purchasing any system by paying for the rolling stock and supplies, and by paying the company for the remaining years of the concession an annual sum equal to the average net income of the best five out of the preceding seven years.

The expectation was that, after a few years of development, during which time the State would be obliged to advance the companies funds with which to pay charges on capital not yet yielding a profit, there would follow a period of expanding business and rising earnings that would enable the companies, first, to repay their advances from the public Treasury and, later, increase their divi-

dends to the point of profit sharing with the State. It was confidently anticipated that at the end of the concessions the six great lines, developed to the point of perfection under private ownership and operation, would automatically become the property of the State, free of all capital charges, and with such profit-making possibilities that they would provide the funds to meet a large part of the general expenses of the State. But the results of the French guarantee system have been disappointing. There has been no profit-sharing. The Western, after forty-four years continuous appeal to the State on account of its guarantee, became so hopelessly involved in the Treasury finances that the State in 1908 was compelled to exercise its purchase option. Incidentally it has become a greater burden to the Treasury under State operation than it was under private operation. The *Midi*, in the half century prior to the war, was able in only a dozen years to meet its interest and dividends out of earnings. The *Paris-Orléans*, which at one time had some hopes of becoming self-supporting, was just before the war making large appeals to the Treasury. The *Est* was self-supporting before the war. The *Nord* and the *Paris-Lyon-Méditerranée* have always been prosperous and had no need of a guarantee.

State aid in the pioneer days of railroad building in France was of great assistance in providing the capital needed for these enterprises, and in bridging the companies over the early lean years, but in later years the guarantee has only served to entangle the weaker roads in politics and public finance. It has been a handicap to progress, and has stunted private initiative. In the French railway administration there is much discussion of what they term a *régie désintéressée*, that is, an uninterested management. With earnings guaranteed, no financial penalty for inefficiency, and no hope of reward for efficiency, a company with continuously inadequate earnings inevitably drifts into a *régie désintéressée*. The

spirit of initiative is killed, and there is a lowering of operating efficiency. The war, of course, has been an enormous burden to the French roads, and their debts to the State, in addition to the losses they suffered in Northern France, are very heavy. The financial reconstruction of the companies is one of the most pressing domestic problems France has to deal with after the establishment of peace.

The experience of one country is seldom an unfailing guide for another, because of differences in economic conditions, racial characteristics, and national traditions and ideals, but if in this country we embark on a policy of Government guarantee of income on railroad investments, we must do so with our eyes open to the possibilities it invites. If the Government directly guaranteed the income on private investments, how long would it be before the Government assumed control of the business, especially if the private managements failed to earn the income guaranteed, and the public Treasury had to make up the deficit? And would not a guarantee of this character inevitably deaden private initiative? It is the fear of failure as well as the hope of reward that drives men to do their best: to give insurance against failure is to remove one spur to achievement. If Congress inaugurated such a partnership between the Government and private capital, and a large burden eventually fell on the Treasury, as has been the case in France, how long would it be before Congress would turn the whole arrangement upside down? Instead of getting the railroads out of politics, would not such a partnership inevitably drag them more deeply into the meshes of partisan struggles? In a word would not direct guarantee of railroad income by the Government inevitably lead to Government ownership and operation?

To the proposal that the Government shall purchase the roads from their owners and lease them to private

operating companies — thus combining high Government credit with the high operating efficiency of private management — there appear to be insuperable objections. Without guaranteeing the profits of the operating companies (which would deaden individual initiative and deprive the public of the greatest benefits of private operation) it would be impossible to attract private capital to form them; the funds they would be able to use would be so small compared with the volume of business, that normal fluctuations in the revenues from year to year would either wipe them out or produce extraordinary profits. The operation would become a huge speculative enterprise, the very opposite of what is demanded in the public interest. But, even if it were practicable to lease the roads to private operating companies, such a system would soon lead to complete Government control, and the abandonment of private operation. The Government would have invested, say, $18,000,000,000, while the operating companies would not need more than $500,000,000. With a financial interest thirty times as great as the private companies, the Government would sooner or later be compelled to manage its own business. It is plain that Congress could not long keep its hands off a business enjoying the use of billions of dollars worth of public property, paying out more than seven million dollars a day in wages to two million voters, and buying every day four million dollars worth of materials from several thousand private industries. This proposal would also involve Government direction as to how several hundreds of millions of new public money should be spent each year in railroad expansion — meaning, of course, that the political "pork barrel" with sectional "log-rolling" would supersede engineering judgment and financial foresight. The public would not submit to such a political exploitation of its means of transport, and no responsible private capital could be found to engage in such a hazardous enterprise.

If we are to retain the advantages of private initiative, and save our transportation system and all our machinery of production from the deadening blight of political meddling, we ought to consider well the dangers involved in any proposal for a financial partnership between the railroads and the Government. While before the war our system of public control had its obvious faults, under it was developed the most perfect transportation machine in the world. The best railroads of Europe are many years behind ours in engineering development and operating efficiency. With this achievement before us, should we not attempt to correct the recognized faults in our system of regulation, and build on the sure foundation of the past, rather than enter on an era of political experimenting with new and untried policies? If we are to have a more definite guarantee that capital and brains devoted to the production of transport shall be fairly rewarded, let us find a formula that will not admit of too easy translation into Government ownership.

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